

D.T.E. 02-57

Petition of Aquarion Water Company of Massachusetts, pursuant to G.L. c. 164, § 14 and G.L. c. 165, § 2, to incur long-term debt in the principal amount of up to \$3,600,000.

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FOR: AQUARION WATER COMPANY OF  
MASSACHUSETTS  
Petitioner

## I. INTRODUCTION

On September 25, 2002, Aquarion Water Company of Massachusetts (“Aquarion” or “Company”) filed a petition with the Department of Telecommunications and Energy (“Department”), requesting authority to incur long-term indebtedness in the amount of up to \$3,600,000, with an effective interest rate net of loan subsidy of zero percent.<sup>1</sup> The Company seeks this financing to construct a new water filtration and treatment facility in Millbury, Massachusetts. The Department docketed this matter as D.T.E. 02-57.

Pursuant to notice duly issued, the Department held public and evidentiary hearings at the Department’s offices on October 23, 2002. No petitions for leave to intervene were filed. At the evidentiary hearing, the Company presented three witnesses in support of its petition: Keith Bossung, president of Aquarion; Thomas Errichetti, assistant treasurer of Aquarion and treasurer of Aquarion Water Company of Connecticut (“Aquarion Connecticut”); and Jason Page, senior engineer of Aquarion Connecticut. The evidentiary record consists of 13 exhibits and one response to a Department record request.

## II. DESCRIPTION OF THE PROPOSED FINANCING

The Massachusetts Water Pollution Abatement Trust (“MWPAT”) has granted Aquarion \$3,490,950 in financing to construct a new water filtration and treatment facility to be located in the Company’s Millbury service territory (Exhs. AWC-2, at 7; DTE-3

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<sup>1</sup> Section II of this Order describes the interest rate features of the proposed loan.

(Department of Environmental Protection letter dated August 1, 2002)).<sup>2</sup> MWPAT is a public instrumentality of the Commonwealth authorized to assist water suppliers in financing water pollution abatement projects, including water treatment facilities, through the state water pollution abatement revolving fund established pursuant to G.L. c. 29, § 2L.<sup>3</sup>

See G.L. c. 29C, § 2. MWPAT funds its loan commitments through bonds issued under the Drinking Water State Revolving Fund (“DWSRF”) program administered by the Department of Environmental Protection (“DEP”), as well as federal capitalization grants, matching grants, and contract assistance from the Commonwealth of Massachusetts<sup>4</sup> (Exh. AWC-2, at 7).

Each year, MWPAT issues bonds (“Funding Bonds”) of sufficient value to fund those water suppliers found to be eligible for financial assistance by the DEP (Exhs. AWC-2, exh. KWB-3, at 3; DTE-4; Tr. at 18). The Funding Bonds are secured with a reserve fund funded by legislative appropriation that is equal to approximately 40 to 50 percent of the

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<sup>2</sup> The total cost of the Millbury water treatment plant is estimated to be \$4,561,300 (Exh. AWC-2, at 6). Of this amount, approximately \$500,000 in engineering and analysis costs had been expended prior to the Company’s acquisition by Aquarion Water Company in April 2002 (Exh. AWC-2, at 3; Tr. at 8-9).

<sup>3</sup> Although the primary recipients of MWPAT assistance are publicly-owned water suppliers, the Department of Environmental Protection (“DEP”) determined that the Company’s Millbury water treatment plant was a federally-eligible priority project that qualified for financial assistance through MWPAT (Exhs. AWC-2, at 7; DTE 3, DEP letter dated August 1, 2002). See G.L. c. 21, § 27A; G.L. c. 29C, § 18; 310 C.M.R. §§ 45.00 et seq.

<sup>4</sup> Federal and state government assistance for MWPAT is conditioned upon the continuing availability of sufficient appropriations (Exh. AWC-2, exh. KWB-3, Loan Commitment at 3).

aggregate face value of the Funding Bonds issued for that year's disbursements (Exh. DTE-4; Tr. at 18-20). The reserve funds are invested by MWPAT in high-quality, AAA-rated investments with a maturity equal to the term of the Funding Bonds (Exh. DTE-4; Tr. at 19-20). The interest revenue received by MWPAT is then committed to the borrower through the execution of a guarantee investment contract, which serves to offset that portion of the borrower's debt interest cost (Exh. DTE-4). In this way, between 40 and 50 percent of the interest revenue stream to MWPAT is considered to be effectively guaranteed (Exh. DTE-4; Tr. at 20).

The remaining portion of the borrowers' debt interest cost is provided for through a contract assistance commitment executed by the Commonwealth of Massachusetts, whereby the Commonwealth commits itself to contract assistance payments to MWPAT that are used to offset the remaining debt interest cost (Exh. DTE-4). Therefore, assuming the continued availability of government appropriations, MWPAT loans would have an effective interest rate of zero percent to the borrower (Exh. DTE-4).

The MWPAT loan to Aquarion will have a term of 20 years and bear interest at a fixed rate equal to the average interest cost on certain bonds to be issued by MWPAT (Exhs. AWC-1, at 2; AWC-2, at 7). Since the MWPAT funds the loan from proceeds of Funding Bonds to be issued later in 2002, the interest cost of the loan is not yet known, as this interest cost is tied to the true interest cost of the Funding Bonds yet to be issued (Exh. AWC-1, at 7). While the bonds have yet to be issued by MWPAT, the Company states that the interest rate was expected to range between 4.5 percent and 5.5 percent before any loan

subsidies from MWPAT (Tr. at 17-18). The Company states that this interest rate is favorable to ratepayers because it is exempt from federal tax and MWPAT is a strong credit in the capital markets (Exh. AWC-2, at 8).

As discussed above, however, the MWPAT loan commitment to Aquarion provides for the interest costs to be offset by funds received by MWPAT from investment earnings on MWPAT moneys, including federal capitalization grants, matching grants, and contract assistance payments from the Commonwealth (*id.* at 7). The net effect for Aquarion is a zero percent interest loan (*id.*).<sup>5</sup> If the contract assistance payments from the Commonwealth are not available, the Company states it would be obligated to pay the net difference in terms of interest cost on the loan, which it estimated to fall between 2.0 and 2.5 percent (Tr. at 20-21).

Finally, the loan will be repayable in semi-annual installments and is not pre-payable by the Company (Exh. AWC-1, at 2). The Company proposes to apply the proceeds of the loan to (a) finance \$3,490,950 in construction associated with the Millbury water treatment facility, and (b) pay loan origination and cost of issuance fees imposed by MWPAT, which are estimated at \$90,765 (Exh. AWC-3, at 4).

### III. CAPITAL STRUCTURE OF THE COMPANY

As of June 30, 2002, Aquarion's utility plant (including \$3,120,000 in construction work in progress ("CWIP")) was \$34,990,000 (Exh. AWC-3, exh. TRE-3). After removing

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<sup>5</sup> According to Aquarion, MWPAT's zero percent interest loan program will expire at the end of 2002, thereby requiring that the Company close on this loan prior to the end of November (Exh. AWC-3, at 3).

\$5,818,000 in accumulated depreciation and amortization and \$3,120,000 in CIAC, the Company reported a net utility plant of \$26,052,000 (id.).

As of June 30, 2002, the Company reported a total capitalization of \$16,568,959, consisting of \$8,400,000 in long-term debt and \$8,168,959 in common equity (Exh. AWC-3, exh. TRE-1). The Company's common equity balance consisted of \$3,757,100 in common stock, \$1,879,500 in paid-in capital, and \$2,532,359 in retained earnings (id.).<sup>6</sup>

#### IV. STANDARD OF REVIEW

In order for the Department to approve the issuance of stock, bonds, coupon notes, or other types of long-term indebtedness<sup>7</sup> by a water company, the Department must determine that the proposed issuance meets two tests. First, the Department must assess whether the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14.<sup>8</sup> Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II"), citing Fitchburg Gas & Electric Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). Second, the Department must determine whether the Company has

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<sup>6</sup> Aquarion's annual report to the Department for 2001 itemizes paid-in capital as consisting of \$1,135,450 in premiums on common stock and \$744,050 in surplus invested in plant (2001 Annual Return at 201).

<sup>7</sup> Long-term refers to periods of more than one year after date of issuance. G.L. c. 164, § 14.

<sup>8</sup> The provisions of G.L. c. 164, § 14 are applied to water companies pursuant to G.L. c. 165, § 2.

met the net plant test.<sup>9</sup> Colonial Gas Company, D.P.U. 84-96 (1984); see also Milford Water Company, D.P.U. 91-257, at 4-5 (1992); Edgartown Water Company, D.P.U. 90-274, at 5-7 (1990); Barnstable Water Company, D.P.U. 90-273, at 6-7 (1990).

The courts have found that, for the purposes of G.L. c. 164, § 14, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 836, citing Lowell Gas Light Co. v. Department of Public Utilities, 319 Mass. 46, 52 (1946). In cases where no issue exists about whether the management decisions regarding the requested financing were the result of a reasonable decision-making process, the Department limits its review under Section 14 to the question of whether proceeds from an issuance will be used for a purpose that, on its face, is reasonable. Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990).

The Fitchburg I and II and Lowell Gas cases also established that the burden of proving that an issuance is reasonably necessary rests with the company proposing the issuance, and that the Department's authority to review a proposed issuance "is not limited to a perfunctory review.'" Fitchburg I at 678; Fitchburg II at 842, citing Lowell Gas at 52.

Regarding the net plant test, a company is required to present evidence showing that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common

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<sup>9</sup> The net plant test is derived from G.L. c. 164, § 16.

stock outstanding, exclusive of retained earnings) and will continue to do so following the proposed issuance. Colonial Gas Company, D.P.U. 84-96, at 5 (1984).

Where issues concerning the prudence of the Company's capital financing have not been raised or adjudicated in a proceeding, the Department's decision in such a case does not represent a determination that any specific project is economically beneficial to a company or to its customers. In such circumstances, the Department's determination in its Order may not in any way be construed as ruling on the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing. See, e.g., Boston Gas Company, D.P.U. 95-66, at 7 (1995).

#### V. ANALYSIS AND FINDINGS

The Department recognizes that the subsidized nature of the MWPAT loan offers the potential for an effective interest of zero percent, and therefore the MWPAT loan compares favorably with traditional financing sources, such as banks or insurance companies (Exh. DTE-4; Tr. at 17-18). The lower interest rate available through the MWPAT loan would benefit Aquarion's ratepayers through a lower overall cost of capital that would be incorporated into the Company's future rate applications with the Department. Even if further legislative appropriation for MWPAT loan subsidies were to cease, the Department is persuaded that the terms of the MWPAT loan would remain favorable to the Company by virtue of the federal tax-exempt status and credit rating of MWPAT (Exh. AWC-2, at 8; Tr. at 20-21). Based on the foregoing, the Department finds that the issuance of a long-term note in the principal amount of up to \$3,600,000, with an interest rate equal to the rate of interest of MWPAT's

Funding Bonds issued to fund the recipients of MWPAT drinking water project loans for the year 2002 and a term of 20 years, is reasonably necessary for the stated purposes of financing \$3,490,950 in costs associated with the Millbury water treatment facility as well as approximately \$90,765 in loan origination and issuance costs.

The record demonstrates that, with the issuance of up to \$3,600,000 in long-term debt, Aquarion's total common stock, premium on common stock, and long-term debt will not exceed the Company's net utility plant following the issuance of the MWPAT debt (Exh. AWC-3, exh. TRE-1). Accordingly, the Department finds that the Company's issuance of up to \$3,600,000 in long-term debt meets the net plant test as provided in G.L. c. 164, § 16.

Issues concerning the prudence of the Company's Millbury water treatment plant project have not been raised in this proceeding, and the Department's decision in this case does not represent a determination that this project is economically beneficial to the Company or its customers. The Department emphasizes that its determination in this Order shall not in any way be construed as a ruling relative to the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing.

V. ORDER

Accordingly, after due notice, hearing, and consideration, the Department hereby

VOTES: That the execution of a 20-year note by Aquarion Water Company of Massachusetts in the aggregate principal amount of up to \$3,600,000, with an interest rate equal to the rate of interest of MWPAT's Funding Bonds issued to fund the recipients of MWPAT drinking water project loans for the year 2002, is reasonably necessary for the purposes for which it is proposed; and it is

ORDERED: The Aquarion Water Company of Massachusetts shall be authorized to enter in a 20-year note by Aquarion Water Company of Massachusetts in the aggregate principal amount of up to \$3,600,000 with an interest rate equal to the rate of interest of MWPAT's Funding Bonds issued to fund the recipients of MWPAT drinking water project loans for the year 2002; and it is

FURTHER ORDERED: That the proceeds from such issuance of debt shall be used for the purposes as set forth herein; and it is

FURTHER ORDERED: That the Secretary of the Department shall within three days of the issuance of this Order cause a certified copy of it to be filed with the Secretary of the Commonwealth.

By Order of the Department,

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Paul B. Vasington, Chairman

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James Connelly, Commissioner

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W. Robert Keating, Commissioner

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Eugene J. Sullivan, Jr., Commissioner

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Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).